

Internal Revenue Service

memorandum

CC:TL-N-5485-90

VWATERS

date: JUL 3 1990

to: District Counsel, Portland W:POR  
Attn: Cheryl B. Harris

from: Acting Branch Chief  
Tax Shelter Branch CC:TL:TS

subject: [REDACTED]  
TL-N-5485-90  
CC:TL:TS Waters, Wilson  
I.R.C. § 6229  
Statute of Limitations, TEFRA

This memorandum is in response to your request dated March 29, 1990, regarding the above-mentioned subject.

ISSUE

Whether a consent to extend the period of limitations extends the period of limitations with respect to all shareholders where it was executed by a shareholder who was not the tax matters person under Temp. Treas. Reg. § 301.6231(a)(7)-1T?

CONCLUSION

The Service may issue a notice of final S corporation administrative adjustment where, based on all the facts and circumstances, there is reason to believe that the purported tax matters person was, in fact, authorized to extend the period of limitations, even if such authorization was not in accordance with Temp. Treas. Reg. § 301.6231(a)(7)-1T. If it is determined that the S corporation informally designated [REDACTED] as the TMP or granted him authority to execute the statutory extensions, the consents are effective to extend the period of limitations with respect to all shareholders. If the case is petitioned and the petitioner raises the period of limitations issue, the Service should move for further discovery and apply a facts and circumstances analysis to determine whether the purported TMP had authority to execute the extension on behalf of all shareholders.

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In applying the facts and circumstances analysis, the Service should consider several factors, such as whether the purported TMP could have been designated to be TMP by the S corporation and whether the shareholder was in fact authorized by the S corporation to act as TMP.

#### FACTS

[REDACTED] is a TEFRA S corporation with four shareholders ([REDACTED]). Each individual owns an equal [REDACTED] percent interest. The Service examined the S corporation for the years ended [REDACTED] and [REDACTED]. At the present time, the [REDACTED] return is still an active case, awaiting the issuance of the [REDACTED] day letter.

The examination of the [REDACTED] year was initiated in [REDACTED]. The S corporation did not designate a TMP on this return. The original period of limitations for the [REDACTED] return was [REDACTED]. However, on [REDACTED], a statute extension was obtained on a Form 872-S, extending the statute until [REDACTED]. This extension was signed by [REDACTED] as TMP. On [REDACTED], an additional extension was obtained on a Form 872-S, extending the statute until [REDACTED]. This extension was also signed by [REDACTED] as TMP.

When determining who was the TMP, the examining agent discussed the case with the group manager. They agreed that [REDACTED]'s name came first in the alphabet, but since [REDACTED] ran the business and held himself out to be the contact person for examination, he was treated as the TMP. [REDACTED] had signed the original return, statute extensions and Power of Attorney. Accordingly, although the S corporation had not formally designated [REDACTED] in writing as the TMP, he was acting in that capacity. In addition, when informed that there may be a problem in treating him as TMP, he stated that he would continue to act as TMP even if he was not designated TMP by title. The S corporation has not raised the issue of whether the period of limitations has expired or whether the TMP designation was improper.

#### DISCUSSION

The unified audit and litigation provisions ("TEFRA") are generally extended to and made applicable to S corporations by section 6244. The period of limitations for assessing tax to the shareholder from a change in the treatment of an S corporation item is generally controlled at the S corporation level. See I.R.C. § 6221. Pursuant to section 6229(a), the period for assessing any tax imposed by subtitle A attributable to

partnership or affected items shall not expire before 3 years after the later of the date the corporate return was filed or the last day for filing such a return.

The period of limitations for assessment under section 6229(a) can be extended by an agreement pursuant to section 6229(b). Section 6229(b) provides:

(1) In general.--The period described in subsection (a) (including an extension period under this subsection) may be extended--

(A) with respect to any [shareholder], by an agreement entered into by the Secretary and such [shareholder], and

(B) with respect to all [shareholders], by an agreement entered into by the Secretary and the tax matters [person] (or any other person authorized by the [S corporation] in writing to enter into such an agreement),

before expiration of such period.

In this case, there were two Forms 872-S executed by [redacted] as TMP. Pursuant to section 6231(a)(7)(A), the TMP of any S corporation is a shareholder designated by the S corporation to be the TMP. Temp. Treas. Reg. § 301.6231(a)(7)-1T provides the procedures that the S corporation must follow to designate a TMP. If there is no shareholder who has been so designated, the TMP is the shareholder having the largest profits interest in the S corporation at the close of the taxable year involved. I.R.C. § 6231(a)(7)(B). If more than one shareholder has the largest profits interest, then the TMP is the shareholder whose name appears first alphabetically. However, if there is no shareholder designated by the S corporation to be the TMP and the Secretary determines that it is impracticable to apply the largest profits interest rule, the shareholder selected by the Secretary shall be treated as the TMP. I.R.C. § 6231(a)(7). Cf. Rev. Proc. 88-16, 1988-1 C.B. 691, section 3.03.

The facts indicate that no designation in accordance with section 301.6231(a)(7)-1T was made by the S corporation for the [redacted] taxable year. Therefore, the Service should have applied the largest profits interest rule in determining the TMP. There were four shareholders in [redacted], each of whom held a [redacted] percent interest. [redacted] was not the TMP under the largest profits interest rule since his name did not appear first alphabetically. [redacted]'s wife, was the shareholder with the largest profits interest whose name appeared first alphabetically. The Service made no determination that it

was impracticable to apply the largest profits interest rule. Rather, the Service treated [REDACTED] as TMP since he handled the day to day operation of the corporation and was the most knowledgeable shareholder.

Our prior position regarding cases where the S corporation did not comply with the designation procedures of Temp. Treas. Reg. § 301.6231(a)(7)-1T was that a statutory extension would not be effective to extend the period of limitations on behalf of all shareholders unless the purported TMP was authorized by the S corporation in writing to execute the extension. See Temp. Treas. Reg. § 301.6229(b)-1T. Under this interpretation, the Forms 872-S executed by [REDACTED] as TMP would be ineffective to extend the period of limitations for assessment with respect to all partners unless he was authorized by the S corporation in writing to execute such extensions.<sup>1/</sup> I.R.C. § 6229(b)(1)(B).

We have reconsidered the issue of whether a consent will be effective to extend the period of limitations with respect to all shareholders where the S corporation did not comply with the regulations for designating a TMP. We have determined that the Service may issue a notice of FSAA where, based on all the facts and circumstances, there is reason to believe that the purported TMP was, in fact, authorized to extend the period of limitations, even if such authorization was not in accordance with the regulations. If it is determined that the S corporation informally designated [REDACTED] as the TMP or granted him the authority to execute the statutory extensions, the consents are effective to extend the period of limitations with respect to all shareholders. If the case is petitioned and the petitioner raises the period of limitations issue, the Service should move for further discovery and apply a facts and circumstances analysis to determine whether the purported TMP had authority to execute the extension on behalf of all shareholders.

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<sup>1/</sup> Temp. Treas. Reg. § 301.6229(b)-1T provides the requirements for such a person to extend the statute. The partnership must file a statement with the Service Center where the partnership return was filed. The statement must:

(1) provide that it is an authorization for a person other than the tax matters partner to extend the assessment period with respect to all; (2) identify the partnership and person authorized by name, address and taxpayer identification number; (3) specify the taxable year or years for which the authorization is effective; and (4) be signed by all persons who were general partners at any time during the year or years for which the authorization is effective.

In applying the facts and circumstances analysis, several factors should be considered in determining whether the purported TMP had authority to execute the extension on behalf of all shareholders. First, the purported TMP must have been eligible to be designated TMP by the S corporation. In the case of an S corporation, the TMP must be a shareholder of that corporation.<sup>2/</sup> See Gold-N-Travel, Inc. v. Commissioner, 93 T.C. 618 (1989). This consideration is satisfied in this case where Vernon Morgan is a shareholder who is eligible to be TMP.

Another factor to be considered is whether the shareholder was in fact authorized by the S corporation to act as TMP. In Chomp Associates v. Commissioner, 91 T.C. 1069 (1988), the Tax Court upheld the authority of a TMP to file a petition in his capacity as TMP despite the fact that the partnership failed to comply with Temp. Treas. Reg. § 301.6231(a)(7)-1T(e) in designating the TMP. Rather than focusing on designation in compliance with the regulation, the court considered the key issue to be whether the partner was in fact authorized by the partnership to act as TMP. While we believe that the Service may hold a partnership or S corporation to specific compliance with the regulations, where the Service has reasonably relied on someone holding himself out as TMP, we should be able to apply the Chomp Associates analysis.

In Chomp Associates, the party filing the petition had not been expressly designated as TMP in accordance with the regulations prior to the issuance of the notice of FPAA, but had been authorized to file the petition as TMP by over 96 percent of all partnership interests. The Tax Court framed the issue as follows:

Jurisdictionally, we believe that the temporary administrative regulations do not play a significant role, if any, regarding whether [the filing party] had the authority to file a petition. The more obvious purpose of respondent's regulations is to provide respondent with the name and address of the TMP to be able to properly mail a FPAA. As stated above, the question is whether [the filing party] was duly authorized to file the petition in this case, not whether he properly notified respondent.

Id. at 1078. Thus, the court considered the key issue as being whether the partner was in fact authorized by the partnership to act as TMP. See also Modern Computer Games, Inc. v. Commissioner, T.C. Memo. 1989-483 (the filing shareholder was the

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<sup>2/</sup> In the case of a partnership, the partnership may only designate a general partner to be TMP. See I.R.C. § 6231(a)(7); Temp. Treas. Reg. § 301.6231(a)(7)-1T(b)(1).

proper party, rather than the shareholder with the greatest interest in corporate profits, because he was eligible to be the tax matters person and had been specifically authorized by the S corporation to act as such prior to filing the petition).

In light of Chomp Associates and Modern Computer Games, we believe that it is important to attempt to verify at the administrative level that the other shareholders in this case were aware of [REDACTED]'s representations that he was the S corporation's TMP and that the other shareholders did not object. We recommend that you seek such evidence along these lines to support an argument that [REDACTED] had apparent authority or that his action had been ratified by the other shareholders.

We note that Treas. Reg. § 301.6231(a)(7)-1T regarding the requirements for designating a TMP had been promulgated in March 1987, more than two years before the extensions were signed by [REDACTED]. This creates a hazard of litigation regarding whether the Service's reliance on [REDACTED]'s statements that he was authorized to act as TMP was reasonable. Nevertheless, we conclude that overall the facts and circumstances justify the assertion that [REDACTED] was authorized by the S corporation to execute the extensions, if the period of limitations is raised as a defense.

We also note that if it is determined that [REDACTED] did not have the authority to execute the consents on behalf of all shareholders, we nevertheless recommend arguing the validity of the statute extensions with respect to [REDACTED]. Although an improperly designated TMP is not authorized to extend the period of limitations on behalf of the S corporation, he does have authority to extend the period of limitations for himself as a shareholder of the S corporation. See I.R.C. § 6229(b)(1)(A). However, in recommending defense of the validity of a Form 872-S with respect to an improperly designated TMP, we are not suggesting that such an extension form be intentionally used to extend the period of limitations for individual shareholders. Rather, we suggest the use of the usual Form 872 for individuals, modified to expressly refer to S corporation items.

In addition, if, after conducting the facts and circumstances analysis outlined above, it is subsequently determined that [REDACTED] did not have the authority to execute the consents on behalf of all shareholders, it is Service position that the docket attorney has a professional responsibility to disclose the facts regarding the period of limitations to opposing counsel. The Service should give notice to opposing counsel only where an analysis of the various factors indicates that the purported TMP did not have authority to execute the extension on behalf of all shareholders.

If you have any additional questions regarding this matter,  
please contact Vada Waters at (FTS) 566-3289.

  
CURTIS G. WILSON